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Second Circuit Reaffirms That Attorney-Client Privilege Is Not Waived By Sharing Documents With Parties Pursuant to a Common Legal Interest—Even Where That Interest Has Commercial Objectives

By Alan J. Brudner, Steven P. Solow and Camille Richard

On November 10, 2015, the US Court of Appeals for the Second Circuit issued an opinion reaffirming that the attorney-client privilege and work product protections were not waived by a businessman and his company when they shared legal opinions and communications with a consortium of banks pursuant to a common interest agreement, even though the common legal interest among them—obtaining favorable tax treatment for a transaction—had significant commercial goals. *Schaeffler v. United States*, 2015 U.S. App. LEXIS 19617 (2d Cir. N.Y. Nov. 10, 2015). As the Court held, "the fact that the Consortium [of banks] stood to lose a lot of money (along with appellants) if appellants' tax arguments failed is not support for the position that no common legal interest existed. To the contrary, it was the interest in avoiding the losses that established a common legal interest." *Id*.

The significance of the Second Circuit's *Schaeffler* opinion is the court's apparent effort to stem the tide of judicial opinions that limited application of the attorney-client privilege, or found a waiver, where the reviewing court finds interests beyond a common legal interest (such as a shared commercial interest) and concludes, as did the lower court in *Schaeffler*, that the existence of that common commercial interest invalidated a legitimate common legal interest. Be careful though; it will not suffice to simply claim "Attorney-Client Privileged" on communications made for such purposes as evaluating "the commercial wisdom" of various options. There must be the benchmark purpose of communicating "solely for the obtaining or providing of legal advice." Once that can be established, the Second Circuit is now prepared to protect that privilege even where the privileged information that was shared relates to a common business interest as well.

Background and Summary

The *Schaeffler* decision arises out of an €11 billion loan agreement between the Schaeffler Group, an automotive and industrial parts supplier owned by George Schaeffler, and a consortium of banks that financed the Schaeffler Group's bid to buy German company Continental AG in 2008. Two days prior to the end of the bidding period, Lehman Brothers collapsed and, with it, the stock market and the shares of Continental. German Law prohibited the Schaeffler Group from withdrawing its tender offer prior to the expiration of the bidding period, leaving it oversubscribed; the Schaeffler Group thus held nearly 90 percent of Continental's shares, facing potential insolvency and inability to pay the

If you would like more information, please do not hesitate to contact your Katten attorney or the following attorneys from Katten's **Litigation and Dispute Resolution** practice.

Alan J. Brudner
+1.212.940.6362
alan.brudner@kattenlaw.com

Steven P. Solow
+1.202.625.3550
steve.solow@kattenlaw.com

consortium. To avoid these dire consequences, the Schaeffler Group refinanced its acquisition debt with the consortium. It also sought advice from Ernst & Young on the tax implications and potential IRS litigation arising out of the refinancing. The IRS soon began an audit of Mr. Schaeffler and his company, leading to the issuance of a summons for documents held by E&Y that had been disclosed to the consortium, including some that contained legal opinions and analysis. The summons did not request documents prepared by Schaeffler's law firm or privileged documents that had not been provided to the banks.

Moving to quash the summons, the appellants sought to withhold, in particular, a 58-page E&Y memorandum that identified and analyzed in detail the potential US tax consequences of the refinancing and restructuring, the possible Internal Revenue Service (IRS) legal challenges to the Schaeffler Group's tax treatment of the transaction, and relevant law. The district court denied the motion, holding that the Schaeffler Group had waived the attorney-client privilege by sharing the E&Y memorandum with the consortium. In the court's view, the consortium did not have any "common legal interest" with the appellants because it would not be named as a party to the anticipated litigation with the IRS, and had only economic interests at risk. As such, the district court held, the joint defense privilege exception to the waiver by third-party disclosure rule, provided in the tax context under 26 U.S.C. § 7525(a)(1), did not apply. The court also denied the assertion that the memorandum was protected as work product, finding that the appellants would have received precisely the same advice from E&Y even if litigation had not been anticipated.

Rejecting the district court's analysis, the Second Circuit held: "[a] financial interest of a party, no matter how large, does not preclude a court from finding a legal interest shared with another party where the legal aspects materially affect the financial interests." The panel explained that the parties' common legal interest in trying to obtain favorable tax treatment, as explicated in the E&Y memorandum, was not negated by its commercial consequences. The Second Circuit further clarified case law involving criminal prosecutions, which usually refer to "common defense strategy according to the contours of a particular charging instrument." While such a joint defense likewise preserves privilege among parties sharing information, the Second Circuit noted that for the protection to apply in the context of civil proceedings, the cases "emphasize" the parties' need "to identify a common legal interest or strategy in obtaining a particular goal," but that litigation need not be ongoing.

The Second Circuit also held that the E&Y memorandum was protected as attorney work-product, acknowledging that the highly detailed tax analysis and advice set forth in the memorandum was specifically geared to an anticipated audit and the "highly likely" litigation anticipated to follow it. The panel reaffirmed the dual-purpose doctrine established in *United States v. Adlman*, 134 F.3d 1194 (2d Cir. 1998), that a document "created to assist in large, complex transactions with uncertain tax consequences" is eligible for work-product protection "if in light of the nature of the document and the factual situation in the particular case, the document can fairly be said to have been prepared or obtained *because of* the prospect of litigation." The Second Circuit rejected the district court's construction of a hypothetical scenario in which the Schaeffler Group faced exactly the same business and tax issues but did not anticipate litigation, finding that this scenario "ignored reality." The Second Circuit opined, "[t]he size of a transaction and the complexity and ambiguity of the appropriate tax treatment are important variables that govern the probability of the IRS's heightened scrutiny and, therefore, the likelihood of litigation."

The Second Circuit vacated the judgment and remanded the case for the district court to determine whether any remaining documents sought by the IRS summons also were protected by the attorney-client privilege or work-product doctrine.

Implications

As noted in the Second Circuit's *Schaeffler* opinion, there are judicial opinions written as if a common litigation strategy is the only kind of legal interest that will preserve the attorney-client privilege in the context of a joint defense or common interest agreement. That is essentially the error the Second Circuit corrected in *Schaeffler*. However, the Second Circuit was careful to note that a communication can only be considered privileged in the first place if its purpose is "solely for the obtaining or providing of legal advice," and further that "[c]ommunications made for purposes of evaluating the commercial wisdom of various options" are not privileged even if they contain some legal advice. So the Second Circuit appears not to have wanted *Schaeffler* to be viewed as a groundbreaking decision, and businesspeople should put down their pens before they start writing "Attorney-Client Privileged" on every sheet of paper in sight. That said, in light of *Schaeffler*, a well-crafted common interest agreement should be helpful, if not dispositive, in countering a claim of waiver where the common legal interest among the parties who have shared privileged information is the attainment of a positive commercial outcome.

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